A Pension Primer

A Report by the
National Council of Welfare

Summer 1996

Canada

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Copies of this publication may be obtained from:

National Council of Welfare
2nd Floor, 1010 Somerset Street West
Ottawa K1A 0J9
(613) 957-2961
FAX: (613) 957-0680

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INTRODUCTION

Canada's retirement income system is supposed to perform two essential tasks. The first is to ensure that elderly people have incomes high enough to allow them to live in dignity no matter what their circumstances were during their working years. The second is to maintain a reasonable relationship between income before and after retirement so that old age does not bring a drastic reduction in a person's standard of living.

Neither one of these objectives is being fully met. More than half a million people 65 and older live in poverty. Many workers with average incomes experience a sharp drop in their living standards when they retire. Only the rich have the luxury of not worrying about money, yet they are the greatest beneficiaries of the tax breaks provided by governments to help people build up nest eggs for their retirement years.

A Pension Primer is a guide for people with no special expertise in pensions. It is an update of reports published by the National Council of Welfare in 1984 and 1989 and incorporates a number of changes in retirement income plans that were enacted by governments in recent years. It also highlights major shortcomings that have still not been addressed.

The report provides detailed information about each of the three levels of the retirement income system, and it gives a preview of major changes being considered for the future by the federal government.

The first level is made up of federal, provincial and territorial income security programs. The best known of these is the federal Old Age Security pension paid to most Canadians 65 and older. The other federal programs are the Guaranteed Income Supplement for low-income seniors and the Spouse's Allowance for some low-income people 60 through 64.

The second level is made up of the Canada Pension Plan and its sister plan in Quebec, the Quebec Pension Plan. Both plans are run by governments and ensure that members of the paid labour force put aside a modest portion of their current earnings to provide a modest amount of retirement income.

The third level includes occupational pension plans - often called private plans or employer-sponsored plans - and individual registered retirement savings plans or RRSPs. Together with benefits from the Canada and Quebec Pension Plans, these plans are supposed to replace a large portion of pre-retirement earnings.

An overview of the three levels can be found in Appendix A. Appendix B outlines income tax breaks for seniors.

THE FIRST LEVEL: INCOME SECURITY PROGRAMS

The first level of the retirement income system provides basic income to older Canadians. It is made up of three federal programs - the Old Age Security pension, the Guaranteed Income Supplement and the Spouse's Allowance - and "top-up" programs financed entirely by five provincial governments and the two territorial governments.

Old Age Security (OAS)

The cornerstone of income security programs for elderly Canadians is the Old Age Security pension. About 3.5 million people 65 and older receive old age pension cheques every month at a cost to the federal treasury of more than $16 billion a year.[1]

Benefits are raised every January, April, July and October in line with increases in the Consumer Price Index of Statistics Canada. This technique, called indexation or indexing, prevents the purchasing power of benefits from being eroded by inflation.

In 1995, the OAS pension was $387.74 a month during the first quarter of the year, $388.52 a month during the second quarter, $392.41 a month during the third quarter and $394.76 a month during the fourth quarter. The monthly payments added up to $4,690.29 for the year as a whole.

In 1996, the payments were $394.76 a month in the first quarter and $395.55 in the second quarter.

Old Age Security payments are taxable, so a portion of the cost is recovered by government. However, most elderly Canadians have low or modest incomes and pay little or no income tax.

For many years, the old age pension was a "universal" social program, because benefits went to everyone 65 and older subject only to residence requirements. Seniors qualified for

benefits regardless of whether they were retired or working and regardless of any other sources of income.

Proposals in the federal budget speech of April 1989 later enacted by Parliament ended the universal nature of the program. The technique used was a "clawback" of Old Age Security benefits. High-income seniors continued to receive their Old Age Security cheques every month, but they had to repay all or some of the amounts they received during the year at income tax time.

For the 1995 tax year, seniors had to pay back their OAS benefits at a rate of 15 cents for every dollar of net income above $53,215. Seniors with net incomes of $84,484 or more had to repay the entire OAS pension.

As of July 1996, the federal government planned to withhold an amount equal to the clawback from monthly OAS cheques. That should end the charade of the federal government sending out cheques to wealthy seniors every month only to recapture the money at tax time.

Three other changes or attempts to make changes in the Old Age Security pension in recent years are worthy of mention. Proposals for more sweeping changes in the future are described at the end of this chapter.

New residence requirements were introduced in 1977. Seniors once qualified for full old age pensions if they had lived in Canada at least ten years. Under the new requirements, people who spend any appreciable part of their adult lives outside Canada have to "earn" their old age pensions at a rate of 1/40th of the full pension for each complete year of residence after age 18. No benefits are paid to people who lived less than ten years in Canada unless they came from countries which have international social security agreements with Canada. By January 1996, there were 147,000 seniors or four percent of the total of 3.5 million who were receiving less than full Old Age Security pensions.[2]

Secondly, caps were placed on the amount of indexation provided in the old age pension in 1983 and 1984 under the "six-and-five" anti-inflation program of the federal government. Indexation was to be limited to six percent in 1983 and five percent in 1984. The actual impact

on pensioners turned out to be nil because the rate of inflation began falling sharply before the beginning of 1983. Full indexation officially resumed in 1985.

Finally, in the budget speech of May 1985, a different kind of limit on indexation was proposed by the federal government in order to help trim the deficit. The Old Age Security pension would have been indexed only for inflation in excess of three percent a year. In other words, pensioners could have lost three percent of the purchasing power of their old age pension cheques each year. This proposal was withdrawn a few weeks after the budget because of protests by seniors and others, and the old age pension remains fully protected against inflation.

Guaranteed Income Supplement (GIS)

The second federal program for the elderly is the Guaranteed Income Supplement. It was introduced in 1967 to help pensioners who have little income other than their Old Age Security pensions.

Nearly 1.4 million people 65 and older - about 39 percent of all Old Age Security pensioners - had full or partial Guaranteed Income Supplement payments added to their monthly OAS cheques in 1995. The cost of the supplement to the federal government is $4.7 billion a year.

The maximum supplements paid in the second quarter of 1996 were $470.07 a month for a single pensioner and $612.36 a month for a two-pensioner couple - $306.18 for each spouse. Married people get less than singles because they save money on many types of household expenses by sharing.

The supplements are indexed quarterly to changes in the Consumer Price Index, and there have been several ad hoc increases over the years in addition to these cost-of-living increases. Benefits are not counted as taxable income.

Low-income pensioners receive full or partial Guaranteed Income Supplement payments depending on their income. For every $2 of outside income, benefits are reduced by $1. The

Old Age Security pension and a few other types of benefits do not count as outside income for the purposes of this program.[3]

Table 1 shows how GIS benefits decline and eventually disappear as outside income aside from the old age pension increases. The benefits were those available in the second quarter of 1996 based on outside income received in 1995.

TABLE 1

GUARANTEED INCOME SUPPLEMENT BENEFITS
APRIL - JUNE 1996

Single Pensioner		Each Person in Two-Pensioner Couple	
1995 Income Excluding OAS	Monthly GIS Benefit	1995 Income Excluding OAS	Monthly GIS Benefit
None	$470.07	None	$306.18
$2,000	$387.07	$2,000	$265.18
$4,000	$304.07	$4,000	$223.18
$6,000	$220.07	$6,000	$181.18
$8,000	$137.07	$8,000	$140.18
$10,000	$54.07	$10,000	$98.18
$11,304 or more	$0	$12,000	$56.18
		$14,000	$15.18
		$14,736 or more	$0

Single pensioners with outside incomes of less than $24 a year qualified for the maximum GIS benefit, and they got partial benefits in the second quarter of 1996 if their incomes in 1995 were less than $11,304. Elderly couples with family incomes of less than $48 a year got

maximum GIS benefits, and they received partial benefits if their family incomes in 1995 were less than $14,736.

Across the country, the proportion of elderly Canadians who receive the Guaranteed Income Supplement varies considerably. Roughly seven of every ten pensioners living in Newfoundland and the Northwest Territories qualify for the supplement. In Ontario, three in ten pensioners qualify.

TABLE 2

NUMBER OF PEOPLE RECEIVING OLD AGE SECURITY AND THE GUARANTEED INCOME SUPPLEMENT, JANUARY 1996

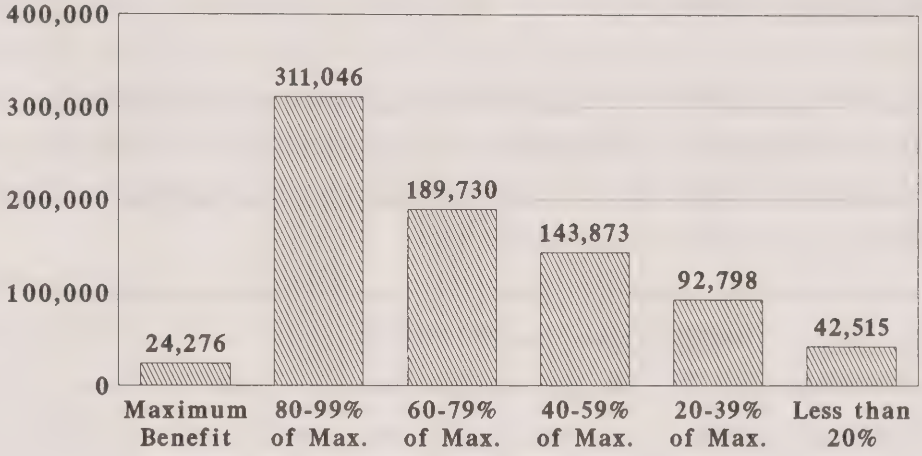
	OAS	GIS	Percentage of OAS Pensioners Receiving GIS
Newfoundland	59,979	42,803	71%
Prince Edward Island	17,340	10,008	58%
Nova Scotia	118,985	60,691	51%
New Brunswick	93,534	52,326	56%
Quebec	853,823	431,428	51%
Ontario	1,286,360	383,219	30%
Manitoba	151,950	63,547	42%
Saskatchewan	145,479	64,280	44%
Alberta	258,411	98,471	38%
British Columbia	453,653	149,789	33%
Northwest Territories	1,858	1,337	72%
Yukon	1,349	533	40%
Outside Canada	49,783	10,905	22%
Total	3,492,504	1,369,337	39%

Poverty among the elderly has declined significantly during the last two decades, but the number of people who have to rely on the supplement to make ends meet is still very high.[4] The financial hardships of single persons are substantially more widespread and severe than the hardships facing couples. And among singles, women are particularly disadvantaged. Nearly 80 percent of all single GIS recipients are women.

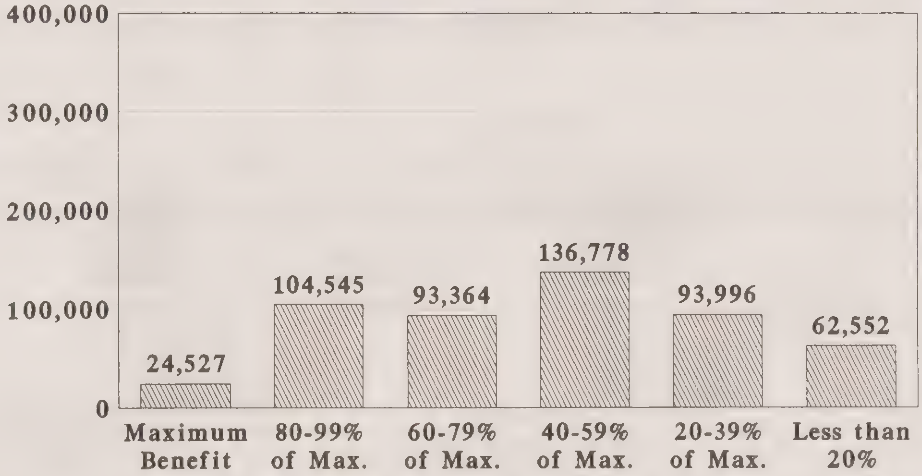
Graph A shows the distribution of Guaranteed Income Supplement benefits for single people and couples as of June 1995. Single recipients tend to have little outside income and are likely to qualify for fairly sizable GIS payments. In 1995, 24,276 of the single people getting the Guaranteed Income Supplement were so poor that they got the maximum possible benefit. Another 311,046 singles got between 80 and 99 percent of the maximum possible benefit.

The picture is noticeably different for married people. A total of 24,527 of the married recipients of the Guaranteed Income Supplement were so poor that they got the maximum possible benefit. Another 104,545 got between 80 and 99 percent of the maximum, but many more got smaller amounts.

Recipients of Guaranteed Income Supplement by Size of Benefit, 1995



Single People



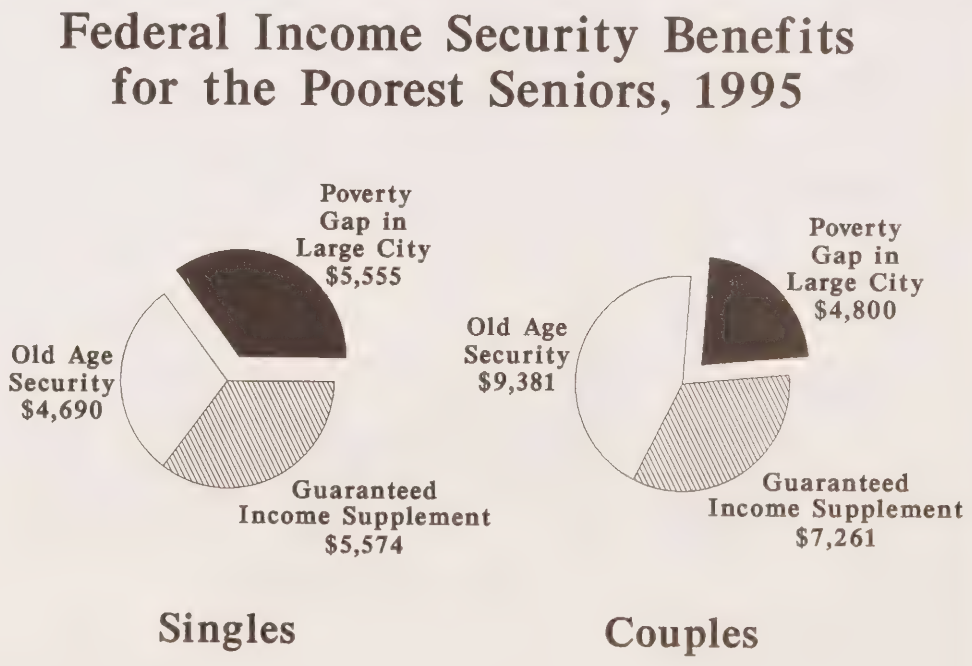
Married People

Graph A

For a single pensioner, the maximum Guaranteed Income Supplement was $5,574 a year in 1995. Together with the Old Age Security pension, a single person was guaranteed an income of $10,264 a year. That amount is just below the 1995 poverty line of $10,769 for a single person living in a rural area but far below the poverty line of $15,819 for a city with a population of 500,000 or more.[5]

For couples, the maximum supplement was $3,631 for each spouse in 1995. Two maximum GIS benefits plus two OAS pensions provided total family income of $16,642. That amount was substantially above the poverty line of $14,600 for couples in rural areas, but well below the poverty line of $21,442 for a large city.

Graph B shows the maximum benefits available in 1995 from the Guaranteed Income Supplement combined with the Old Age Security pension. It also shows a "poverty gap" of $5,555 for a single pensioner living in a large city and a "poverty gap" of $4,800 for a couple in a large city. The term poverty gap refers to the difference between income and the poverty line.



Graph B

In addition to the normal Guaranteed Income Supplement, there is a special GIS for seniors who are recent immigrants to Canada and who do not qualify for full Old Age Security pensions.

Within a few years of the 1977 change in OAS residence requirements, provincial governments expressed concern that some recipients of partial OAS pensions would wind up on welfare. The federal government responded in 1984 by introducing a kind of "super" Guaranteed Income Supplement for these pensioners. In effect, the super GIS covers any losses in OAS as well as providing benefits equivalent to the regular GIS.

The 1996 budget speech proposed to put sharp limits on the super GIS. Residents of Canada for less than ten years who came from countries which have social security agreements with Canada would get no more than 1/10 of the Guaranteed Income Supplement or Spouse's Allowance for each year of residence up to ten years. They would then qualify for normal benefits. However, sponsored immigrants would not be eligible for the Guaranteed Income Supplement or Spouse's Allowance during their period of sponsorship - up to ten years.

Once enacted by Parliament, the new rules would apply immediately to people who arrived in Canada after budget day, March 6, 1996. People who arrived in Canada in previous years and who are already receiving benefits would not be affected at all. People who arrived in previous years and who do not qualify for benefits before Jan. 1, 2001, would fall under the new rules as of that date.

The budget speech said the super GIS for people with less than ten years' residence in Canada is costing the federal government nearly $90 million a year. An estimated $60 million of the total is going to sponsored immigrants.

Spouse's Allowance (SPA)

The Spouse's Allowance, by far the smallest of the three federal income security programs for the elderly, helps a select group of low-income people ages 60 through 64. The program has about 106,000 beneficiaries - the vast majority of them women - and costs the federal government about $436 million a year.

There are two different rates for the Spouse's Allowance. For people married to pensioners who receive the Guaranteed Income Supplement, the maximum Spouse's Allowance in the second quarter of 1996 was $701.73 a month. For widowed people, the maximum monthly allowance was $774.71.

Benefits are reduced as outside income rises and eventually disappear. In 1996, married people 60 through 64 qualified for partial Spouse's Allowances if their family incomes in 1995 were under $21,072. Widows and widowers got Spouse's Allowances if their 1995 incomes were under $15,456.

The payments are not subject to income tax and are raised quarterly in line with the Consumer Price Index.

The Spouse's Allowance dates back to 1975. The program was designed to provide benefits equivalent to the Old Age Security pension and the Guaranteed Income Supplement. The initial target group was people in need 60 through 64 who were married to GIS recipients.

People who got the Spouse's Allowance used to lose all their benefits when their pensioner spouses died. That inequity was eliminated in 1979 under legislation that allows recipients to continue receiving benefits to age 65, when they become eligible for the Old Age Security pension and Guaranteed Income Supplement.

Further changes were enacted in 1985 to open the Spouse's Allowance to all widows and widowers 60 through 64 who are in need.[6] However, the program still does not cover low-income single people 60 through 64 who never married, people 60 through 64 who are divorced or separated, or older couples where both spouses are under 65.

Many of the people who are excluded from the Spouse's Allowance are not in the paid labour force. Their main alternative is welfare, and welfare rates are generally much lower than the allowance.

As with the Guaranteed Income Supplement, the Spouse's Allowance is too small to keep all recipients out of poverty. The maximum Spouse's Allowance for a widow or widower was $9,186 in 1995. That was $6,633 under the poverty line for a large city. For a married person,

the maximum Spouse's Allowance was $8,321. One maximum allowance combined with a spouse's Old Age Security pension and maximum Guaranteed Income Supplement provided family income of $16,641. That was $4,801 below the poverty line for a large city.

One quirk in the Spouse's Allowance program that developed over the years is that benefits continue to be paid at a lower "married rate" when recipients lose their spouses.

A widow or widower 60 through 64 getting the maximum Spouse's Allowance got $774.71 a month in the second quarter of 1996 under a married rate. Meanwhile, a widow or widower 65 or older getting the old age pension and the maximum Guaranteed Income Supplement got $865.62 a month under a single rate - $90.91 a month more.

Provincial and Territorial Income Supplements

Elderly people living in Ontario, Manitoba, Saskatchewan, Alberta, British Columbia, Yukon and the Northwest Territories receive provincial or territorial income supplements as well as federal income security benefits.[7]

At last count, there were an estimated 250,000 seniors receiving provincial and territorial income supplements. The total value of the benefits was in the order of $285 million a year.[8] Most of the supplements are paid monthly, but Manitoba makes quarterly payments.

Unlike federal programs for the elderly, most provincial and territorial programs are not indexed to keep them current with the cost of living. Benefits in Ontario, British Columbia and Yukon have not been raised since the 1980s.

Also unlike federal programs, most provincial and territorial supplements ignore the relatively greater financial needs of single people. Poverty is much more widespread and much more severe among single pensioners than couples. In 1994, 44.1 percent of unattached senior women and 25.2 percent of unattached senior men were poor, compared to only 6.8 percent of senior couples.[9]

Saskatchewan and Alberta pay proportionately larger benefits to singles. In Ontario, Yukon and the Northwest Territories, couples get twice the benefits of single people. Manitoba and British Columbia pay couples more than twice the supplement for single pensioners.

TABLE 3

PROVINCIAL AND TERRITORIAL SUPPLEMENTS FOR THE ELDERLY, 1995

	Maximum Annual Benefit	
	Single Person	Two-Pensioner Couple
Ontario GAINS-A	$996	$1,992
Manitoba 55 Plus	$446.40	$959.20
Saskatchewan Income Plan	$1,080	$1,740
Alberta Seniors Benefits[10]	$2,350	$3,500
British Columbia GAIN	$591.60	$1,446
Yukon Seniors' Income Supplement	$1,200	$2,400
Northwest Territories Senior Citizens' Benefits	$1,620	$3,240

In addition to these supplements, all provinces and territories provide other kinds of benefits to seniors.[11] There may be help to meet housing costs, for example, or relief from local taxes. All these programs are welcome for older people with low or modest incomes, but it is difficult to estimate how much of an impact they really have.

Inadequate Income Support

Federal, provincial and territorial programs together provide minimum guaranteed incomes for elderly people. Unfortunately, these income security benefits are not large enough to keep all seniors out of poverty.

TABLE 4

DIFFERENCE BETWEEN MAXIMUM GOVERNMENT BENEFITS FOR THE ELDERLY AND THE POVERTY LINE, 1995

SINGLE PERSONS

	Maximum Income from Governments	Poverty Line	Poverty Gap
St. John's	$10,264	$13,895	-$3,631
Charlottetown	$10,264	$13,574	-$3,310
Halifax	$10,264	$13,895	-$3,631
Saint John	$10,264	$13,895	-$3,631
Montreal	$10,264	$15,819	-$5,555
Toronto	$11,260	$15,819	-$4,559
Winnipeg	$10,711	$15,819	-$5,108
Saskatoon	$11,344	$13,895	-$2,551
Edmonton	$12,614	$15,819	-$3,205
Vancouver	$10,856	$15,819	-$5,135

MARRIED COUPLES

	Maximum Income from Governments	Poverty Line	Poverty Gap
St. John's	$16,642	$18,835	-$2,193
Charlottetown	$16,642	$18,399	-$1,757
Halifax	$16,642	$18,835	-$2,193
Saint John	$16,642	$18,835	-$2,193
Montreal	$16,642	$21,442	-$4,800
Toronto	$18,634	$21,442	-$2,808
Winnipeg	$17,601	$21,442	-$3,841
Saskatoon	$18,382	$18,835	-$453
Edmonton	$20,142	$21,442	-$1,300
Vancouver	$18,088	$21,442	-$3,354

Table 4 shows the maximum combined benefits for singles and couples living in the largest city in each province in 1995, the poverty lines for each city, and the poverty gaps in each. The two territories are excluded from Table 4 because Statistics Canada excludes them from the Survey of Consumer Finances, the survey which is used to determine the poverty lines.

Among poor single people, the poverty gap ranged from $2,551 in Saskatoon to $5,555 in Montreal. Among poor couples, the poverty gap ranged from $453 in Saskatoon to $4,800 in Montreal.

Overall, it is clear that the government programs that make up the first level of Canada's retirement income system are not generous enough to keep all pensioners out of poverty. Nonetheless, they are indispensable to elderly people, and poverty would be much more widespread and severe without them.

The 1996 Budget and Benefits for Seniors

The budget speech of March 6, 1996, proposed sweeping changes in the way the federal government provides benefits to seniors that would come into effect on Jan. 1, 2001. The centrepiece of the proposals is a new Seniors Benefit for people 65 and older that would replace the Old Age Security pension and Guaranteed Income Supplement. The main features of the new benefit are as follows:

- The maximum benefit would be $120 a year per household higher than Old Age Security and the Guaranteed Income Supplement combined. Low-income single seniors would get an extra $120 a year, and low-income senior couples would share the extra $120.

- The income threshold for reducing benefit entitlements would drop sharply from $53,215 to $25,921. This would have the effect of sharply reducing the amounts received by seniors in middle-income and upper-income ranges.

- Family income, rather than individual income, would be used to calculate benefits.

- The entire new benefit would be non-taxable.

- All features of the benefit would increase automatically with the cost of living.

The Spouse's Allowance program would continue to operate once the new Seniors Benefit is in place, and widows and widowers in the program would get an additional $120 a year.

The budget speech also proposed special transitional proposals that would apply to people who were 60 or older by Dec. 31, 1995 - in other words, 65 or older by Dec. 31, 2000, on the eve of the new system. These people would have the choice of receiving Old Age Security and the Guaranteed Income Supplement under current arrangements for as long as they live or receiving the new Seniors Benefit. Spouses of people who decided to continue under Old Age Security and the Guaranteed Income Supplement would also continue under OAS and GIS, regardless of their age.

Overall, the federal government said 75 percent of seniors would receive the same or higher benefits under the new system. Another 16 percent would receive lower benefits. The remaining nine percent - seniors with the highest incomes - would receive no benefits at all.

THE SECOND LEVEL: THE CANADA AND QUEBEC PENSION PLANS

The second level of the retirement income system is made up of the Canada Pension Plan and the Quebec Pension Plan, a sister plan for residents of the province of Quebec. The plans were started by the federal and provincial governments in 1966 as a way of providing basic pension income for members of the paid labour force and their dependents.

Like the programs that make up the first level of the system, the CPP and QPP are run by governments. Unlike the first-level plans, they are financed by contributions from workers and employers rather than from federal or provincial treasuries.

The Canada Pension Plan covers virtually all members of the paid labour force in nine provinces and the two territories as well as members of the Canadian Forces and RCMP living in Quebec. Changes in the plan require the approval of Parliament and two-thirds of the provinces with two-thirds of the population.

The Quebec Pension Plan covers workers in Quebec and is controlled by the Quebec government. More often than not, its features are identical to those of the Canada Pension Plan.

The two plans provide retirement benefits, disability pensions, benefits to dependent children of deceased plan members and to children of disability pensioners, pensions to surviving spouses and lump-sum death benefits to defray the cost of funeral expenses. More than 4.2 million people are beneficiaries of one plan or the other, and the total benefits paid now exceed $21 billion a year.[12]

Benefits being paid are indexed at the beginning of each year according to changes in the cost of living as measured by the Consumer Price Index. The 1996 increase was 1.8 percent for the Canada Pension Plan and 2.3 percent for the Quebec Pension Plan.

Benefits other than death benefits are paid monthly. All benefits are considered taxable income for the purposes of federal and provincial income taxes.

Workers in the paid labour force between the ages of 18 and 65 make contributions to one or the other of the plans. Workers contribute through regular payroll deductions, and their contributions are matched dollar for dollar by employers. Self-employed people pay both the employee and employer shares.

Total contributions to the Canada Pension Plan are about $10.5 billion a year and contributions to the Quebec Pension Plan about $3.1 billion. Workers get a tax credit for the contributions they make each year.

TABLE 5

MAXIMUM MONTHLY BENEFITS FROM THE CANADA AND QUEBEC PENSION PLANS, 1996

	Canada Pension Plan	Quebec Pension Plan
Retirement at 65	$727.08	$727.08
Disability	$870.92	$870.89
Survivors 65 and Older	$436.25	$436.25
Survivors 55-64	$399.70	$672.25
Survivors 45-54	$399.70	$598.24
Survivors under 45:		
• Not Disabled, No Children	(varies)	$356.05
• Not Disabled, With Children	$399.70	$574.97
• Disabled	$399.70	$598.24
Children and Orphans	$164.17	$52.12

Benefits under both the Canada and Quebec Pension Plans have been improved over the years. The last improvements came into force on January 1, 1987. Several of them brought the Canada Pension Plan into line with improvements previously made in the Quebec Pension Plan.

Here is a more detailed description of benefits and the number of people who receive each kind of benefit.

Retirement Benefits. Just over three million Canadians get CPP or QPP retirement benefits worth a total of $14 billion. The maximum pension is $727.08 a month. The standard age of retirement is 65, but contributors have the option of retiring as early as age 60 with reduced pensions or as late as age 70 with enhanced pensions. The reduction or enhancement rate is one-half of one percent for every month before or after a person's 65th birthday. In other words, people retiring 60 months early at the age of 60 lose 30 percent of their normal CPP or QPP pensions. The reduced rates are permanent and continue even after the pensioners turn 65.

Disability Benefits. There are about 350,000 disability pensioners under the two plans, and they get a total of $3 billion in benefits. Pensions are paid only to those who have severe and prolonged mental or physical problems that make it unlikely they could ever work again. Benefits consist of a flat-rate portion and a portion based on previous earnings. The maximum pension is $870.92 a month.

Children of disabled pensioners under 18 and children 18 to 25 who are full-time students get flat-rate children's benefits from the two plans - $164.17 a month under the Canada Pension Plan and $52.12 a month under the Quebec Pension Plan. Children are entitled to two monthly benefits if both parents are disabled or dead and both were CPP or QPP contributors. The total caseload is about 110,000, and the total benefits are about $250 million.

Survivor Benefits. There are about one million people - 89 percent of them women - receiving survivor pensions valued at $3.2 billion. Benefits are paid to the legal spouse of a CPP or QPP contributor or a common-law spouse who had been living with a contributor for at least one year before the date of death. Divorced people do not qualify for survivor benefits.

The CPP and QPP offer the same benefits to surviving spouses 65 and older - 60 percent of the deceased plan member's retirement pension to a maximum of $436.25 a month - but they have different formulas for spouses under 65. The maximum CPP benefit for a spouse under 65 is $399.70. In the case of surviving spouses between 35 and 45 who are not disabled and do not have dependent children, the maximum benefit is reduced by 1/120 for each month the surviving spouse was under 45 when the CPP contributor died. Surviving spouses under 35 who

are not disabled and have no children do not get any benefits at all. The maximum QPP benefits are $672.25 a month for spouses 55 to 65 and $598.24 a month for spouses 45 to 55. For survivors under 45, there are three different maximum rates in the QPP: $356.05 for a person without children, $574.97 for a person with children and $598.24 for a person with a disability.

Surviving spouses of deceased plan members used to have their pensions cut off if they remarried. The Quebec Pension Plan stopped this practice in 1984 and the Canada Pension Plan followed suit in 1987. Surviving spouses previously cut off because of remarriage had their benefits reinstated.

Children of deceased plan members under 18 or full-time students 18 to 25 get flat-rate children's benefits similar to the benefits paid to the children of disability pensioners. The caseload is about 107,000 and the value of benefits about $215 million.

As we mentioned earlier in this chapter, the money to pay CPP and QPP benefits comes from contributions by workers and their employers and the interest earned on those contributions over the years.

Under the Canada Pension Plan, contributions from workers and employers go into a special government account. Money in the account that is not immediately needed to pay benefits is loaned to provincial and territorial governments at an interest rate that is the same as the current rate on long-term Government of Canada securities.

Under the Quebec Pension Plan, the money goes to a provincial government fund called the Caisse de dépôt et de placement. Surplus funds are invested in a variety of ways, including corporate stocks and bonds, mortgages and provincial government securities.

The Canada and Quebec Pension Plans operate in a different way from the occupational pension plans described in the next chapter of this report.

Sponsors of occupational plans are required by law to maintain reserves large enough to cover the full cost of pension benefits during the lifetime of all retired plan members and the cost of future benefits for plan members still in the labour force. This requirement is known as "full funding."

The main reason occupational plans have to be fully funded is to protect employees in the event the employer goes out of business. Clearly, the federal and provincial governments will not be going out of business, so full funding is not needed in the Canada and Quebec Pension Plans.

The contribution rate under the Canada and Quebec Pension Plans was set at 3.6 percent of contributory earnings - 1.8 percent from workers and 1.8 percent from employers - when the plans were started in 1966. Ottawa and the provinces agreed in 1986 to make small increases in the rate each year beginning in 1987. The contribution rate in 1996 is 5.6 percent of earnings - 2.8 percent from workers and 2.8 percent from employers.

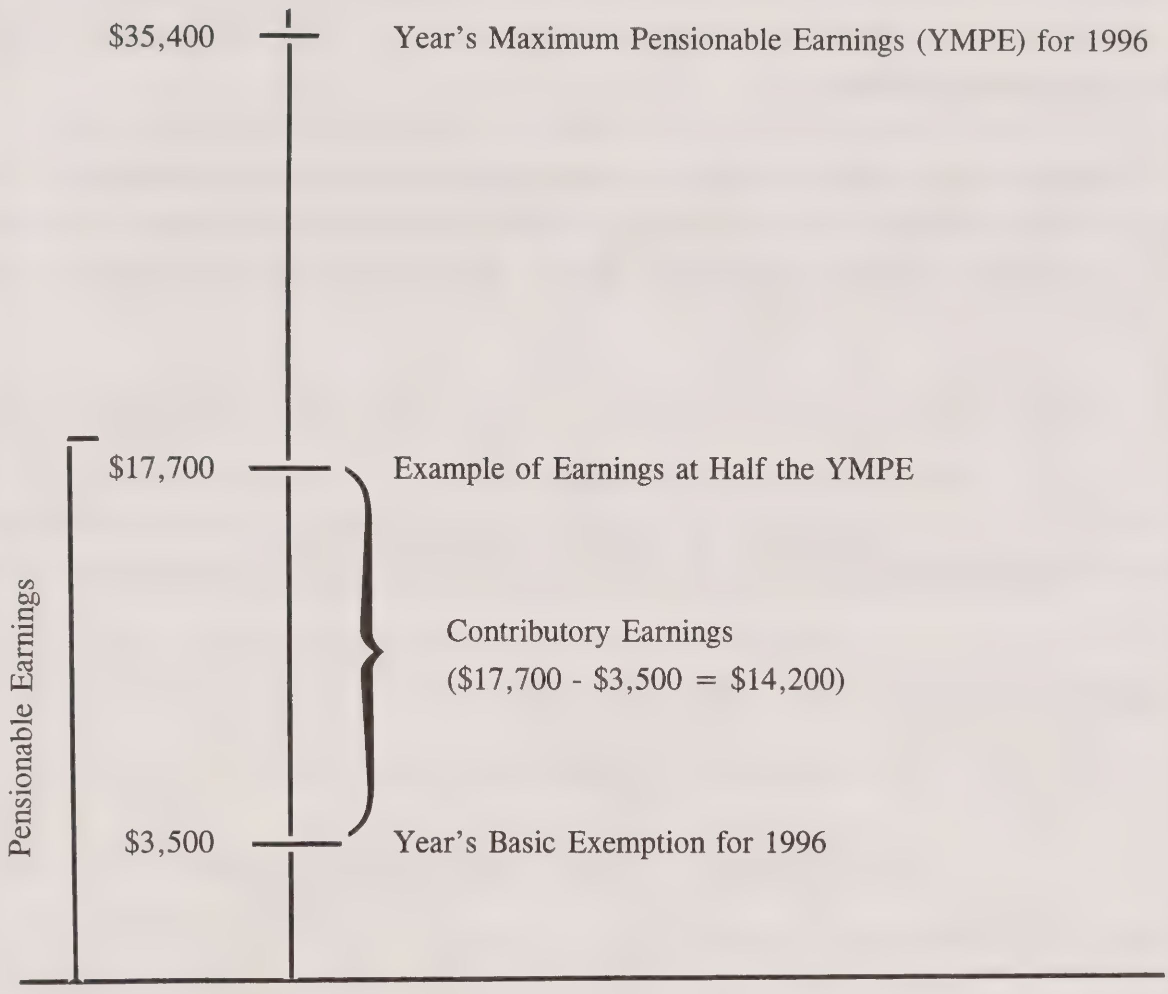
The contribution rate applies to earnings up to an annual maximum called the Year's Maximum Pensionable Earnings, minus the Year's Basic Exemption.

The Year's Maximum Pensionable Earnings or YMPE is an approximation of the average industrial wage and amounts to $35,400 in 1996. The Year's Basic Exemption is roughly ten percent of the YMPE or $3,500.

The exemption was designed in part so that people who have only a fleeting attachment to the paid labour force are not part of the Canada and Quebec Pension Plans. A person who made $1,500 a year doing odd jobs or a student who made $2,000 working at a summer camp would not contribute to the plan, because they earned less than the Year's Basic Exemption of $3,500.

Graph C shows the technical terms used in calculating CPP and QPP contributions and benefits and gives an example of a worker who earns $17,700 in 1996 - half the YMPE of $35,400. The $17,700 in pensionable earnings minus the Year's Basic Exemption of $3,500 produces contributory earnings of $14,200. At the 1996 contribution rate of 5.6 percent, the annual contribution required to the CPP or QPP is $795.20 - $397.60 from the worker and $397.60 from the employer.

CPP-QPP TERMINOLOGY



Graph C

Retirement benefits under the Canada and Quebec Pension Plans are based on earnings up to the YMPE each year. Roughly speaking, workers who earn the average wage or better each year of their careers get the maximum possible CPP or QPP pension. Workers who earn

half the average wage each year wind up with half the maximum possible pension. In calculating a worker's CPP or QPP pension entitlement upon retirement, pensionable earnings from previous years are all adjusted to bring them up to current wage levels.

Not Enough Pension Income

The Canada Pension Plan and the Quebec Pension Plan were designed to replace only 25 percent of earnings up to the average wage. What that means in practical terms is that CPP and QPP retirement benefits combined with the Old Age Security pension are not high enough to keep most people out of poverty.

Table 6 shows the 1995 incomes of pensioners who retired with Old Age Security pensions and the maximum possible CPP or QPP pension. Both the single pensioner and the couple with only one CPP or QPP pension qualified for the Guaranteed Income Supplement and still could not get above the poverty line if they lived in a city of half a million people or more.

TABLE 6

RETIREMENT INCOMES OF SENIORS WITH MAXIMUM CPP OR QPP PENSIONS, 1995

	Single Person with Maximum CPP-QPP Pension	Couple with One Maximum CPP-QPP Pension
Old Age Security	$4,690	$9,381
CPP-QPP Pension	8,558	8,558
Guaranteed Income Supplement	1,410	3,109
Total Income	$14,658	$21,049
Poverty Line for a Large City	$15,819	$21,442

(Figures are rounded to the nearest dollar. Totals may not add because of rounding.)

In reality, many Canadians who receive CPP or QPP retirement benefits get far less than the maximum possible pension because their earnings during their working lives were below average. People who retired and started getting Canada Pension Plan benefits in January 1996, for example, get an average monthly cheque of $409.98 - only 56 percent of the maximum possible cheque of $727.08.

People who retire with these smaller pensions are especially dependent on the Guaranteed Income Supplement. Table 7 shows the incomes of a single person and a couple where CPP or QPP benefits are only half the maximum possible. Even with a sizable GIS payment, the single person ends up $3,352 below the poverty line and the couple $2,585 below the line.

TABLE 7

RETIREMENT INCOMES OF SENIORS WITH ONE-HALF THE MAXIMUM CPP OR QPP PENSION, 1995

	Single Person with Half the Maximum CPP-QPP Pension	Couple with One Spouse with Half the Maximum CPP-QPP Pension
Old Age Security	$4,690	$9,381
CPP-QPP Pension	4,279	4,279
Guaranteed Income Supplement	3,498	5,197
Total Income	$12,467	$18,857
Poverty Line for a Large City	$15,819	$21,442

(Figures are rounded to the nearest dollar.)

The latest available poverty statistics show 430,000 unattached individuals and 373,000 families headed by people under 65 who can be classed as low-wage poor or "working poor."[13] They are in the paid labour force, yet they still live below the poverty line.

Some of these workers are people with temporary job difficulties who can look forward to better-paying jobs in the future. Both the Canada and Quebec Pension Plans take account of this possibility through a "general drop-out" provision. The rule allows contributors to the plans to drop out or disregard earnings from 15 percent of their working lives when calculating career earnings for pension purposes. For example, workers who struggled with below-average wages for seven years of their careers and who got average wages for 40 years would wind up with the maximum possible CPP or QPP pension. They wouldn't be penalized for the seven low-wage years.

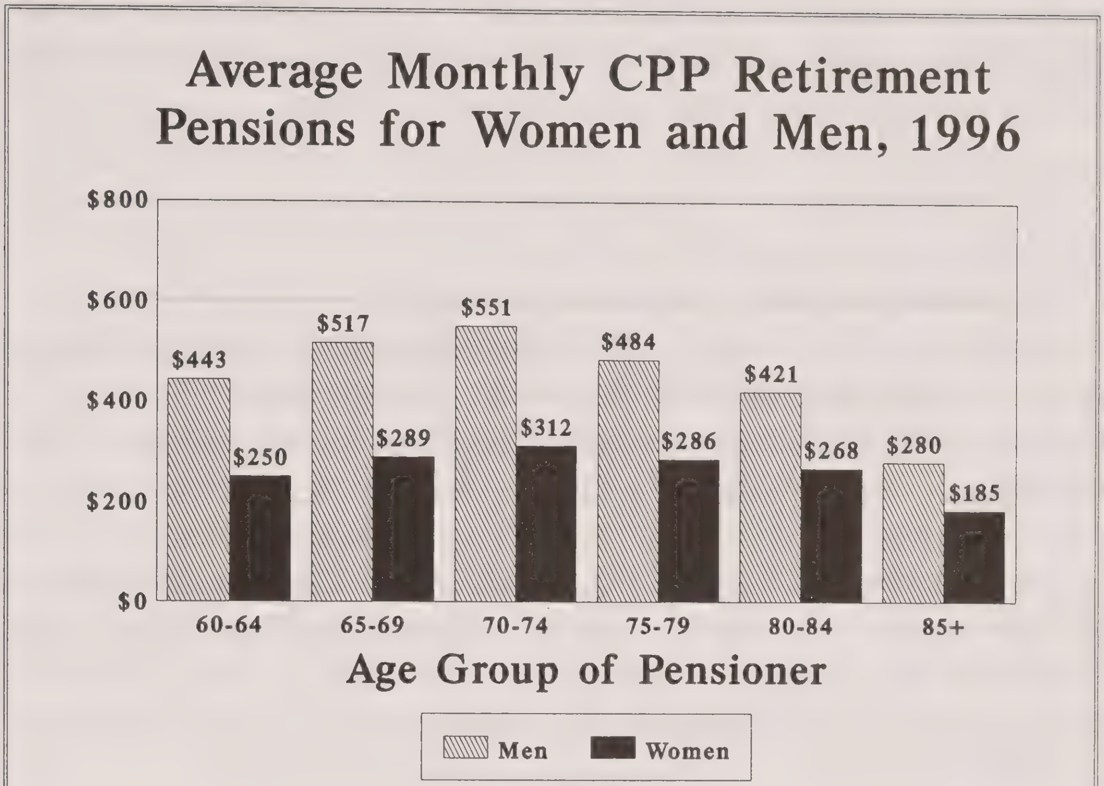
Other members of the working poor will not fare so well. They will be poor year after year because of chronic unemployment, low wages or their inability to get full-time work. When they retire, they will receive CPP or QPP pension benefits far below the maximum, and their only escape from dire poverty will be through the Guaranteed Income Supplement.

The Special Problems Facing Women

The special problems facing women in the labour force are clearly reflected in their retirement benefits from the Canada and Quebec Pension Plans. There are proportionately fewer women than men in paid jobs, so proportionately fewer women wind up with their own CPP or QPP retirement pensions. Women in the labour force are paid much lower wages than men on average, and they have proportionately more part-time jobs and fewer full-time jobs than men, so the size of their pensions tends to be small.

Graph D shows the average monthly retirement pension paid by the Canada Pension Plan in January 1996 to women and men by age group.[14] For pensioners ages 65 through 69, for example, the average benefit paid to men was $517 a month, and the average benefit paid to women was $289 - or 56 percent of the average amount paid to men. By way of comparison, the maximum amount available from the plan for people who retired in January 1996 was $727 a month.

The same general pattern applies to all the age groups shown in the graph, from the women and men who chose to take early retirement before age 65 to the women and men 85 and older who retired many years ago.



Graph D

The statistics are depressing for those who had assumed that the economic equality of the sexes was just a matter of time, given the increasing proportion of women in the paid labour force, affirmative action programs to get women into higher-paying occupations and pay equity legislation based on the principle of equal pay for work of equal value. The reality is that the problems that women face in the labour force today will be reflected in the CPP pensions they receive many years from now.

Several features of the Canada Pension Plan and Quebec Pension Plan help alleviate the disadvantaged position of women.

Women are by far the main beneficiaries of survivor pensions under the two plans. That provides at least minimal income for widowed homemakers who spent all or most of their working lives outside the paid labour force. However, the benefit for a person 65 and older is

only 60 percent of the spouse's CPP or QPP pension to a maximum of $5,235 a year. The average survivor's pension paid by the CPP in January 1996 was only $2,928 a year. Both those levels of incomes keep a person well below the poverty line.

For the last several years, both the CPP and the QPP have an option known as the "child-rearing drop-out" that is of special importance to women who take time off from paying jobs while their children are young. The provision allows parents - either mothers or fathers, but traditionally mothers - who stay home while their children are under the age of seven to exclude those years from the calculation of lifetime earnings. The child-rearing drop-out is in addition to the general drop-out of 15 percent of years worked that is available to all CPP and QPP contributors.

Quebec has had a child-rearing drop-out since 1977, but foot-dragging by Ontario denied similar help to parents in the rest of the country for many years.[15] The drop-out provision in the CPP finally came into effect in 1983, retroactive to January 2, 1978. People who retired beginning in 1978 or later now can drop out child-rearing years back to the beginning of the CPP and QPP in 1966.

Finally, there are provisions in both the CPP and QPP that allow pension "credits" - entitlements to future pension benefits - to be split between spouses if their marriages break down. Under credit-splitting, all pension credits earned by both spouses during their lives together are added up and divided in two. Each spouse eventually gets equal pension benefits for the time they were together.[16]

The latest round of improvements to the Canada Pension Plan was originally supposed to make credit-splitting mandatory on marriage breakdown. However, the actual legislation to amend the plan contained much weaker provisions than agreed to by Ottawa and the provinces. The legislation said credit-splitting would take place upon application unless provincial governments explicitly provided otherwise in their family laws. Saskatchewan decided to override mandatory credit-splitting in 1988.

Credit-splitting elsewhere in Canada remains far from the norm. As of January 1996, only 65,709 applications for splitting had been submitted and approved under the Canada Pension Plan since the option was first available in 1978.

Despite the shortcomings described above - particularly the limited benefits available to the poor and to women - the Canada Pension Plan and Quebec Pension Plan are built on sound and sensible foundations. They cover virtually everyone in the paid labour force, they follow workers when they change jobs anywhere in Canada, and they give pensioners full protection against the loss of purchasing power due to inflation.

Changes Ahead for the Canada Pension Plan

The federal, provincial and territorial governments are holding public hearings across the country this year on possible changes in the Canada Pension Plan that could come into effect as early as 1997. Similar hearings are being held within Quebec on the Quebec Pension Plan. The CPP changes under consideration are outlined in An Information Paper for Consultations on the Canada Pension Plan published in February 1996.[17]

The federal and provincial governments agreed in 1986 to make periodic increases in contribution rates as needed to keep the Canada Pension Plan on a sound financial basis. The information paper proposes an entirely new approach that would see rates rise sharply to a "steady-state" contribution rate in the order of 12.2 percent within the next several years. The paper argues that raising rates more quickly than needed would allow more stable and lower contribution rates in the long term.

Raising rates quickly would mean that more of the cost of providing pensions in the years to come would fall on the workers of today and less on the workers of tomorrow. Higher contribution rates would also lead to a larger CPP reserve fund in the immediate future and would allow governments to experiment with having CPP funds invested in private money markets rather than being loaned to the provinces.

The paper suggests - not very subtly - that the prospect of higher CPP contribution rates in the short term may lead people to support reductions in CPP benefits in the long term. The National Council of Welfare took a strong stand against cuts in benefits in an appearance before a CPP study group in Montreal on May 3, 1996.

Some of the specific cuts proposed in the information paper and the Council's objections are as follows:

- Cutting the maximum retirement pension from 25 percent of pensionable earnings to 22.5 percent. The current pension of 25 percent of pensionable earnings is not large enough to keep seniors out of poverty. Any reduction would increase poverty among seniors. It would also increase federal government expenditures on the Guaranteed Income Supplement and add to the size of the federal deficit in the process.

- Reducing the general drop-out from seven years to five years. The current system allows up to seven years of low earnings or no earnings to be excluded from the calculation of pension entitlements. Seven years is probably not enough in today's uncertain labour markets, and reducing the drop-out to five years would be a step in the wrong direction.

- Increasing the normal age of retirement to 67. This does not strike us as good labour market policy, particularly at a time of relatively high unemployment among older workers. Some of the delays in entitlements to CPP pensions would probably be offset by increased reliance on welfare. Keeping more older workers in the labour force would effectively take away jobs from younger workers.

- Stepping away from full indexing of benefits. Seniors rely heavily on fixed sources of income and need full protection against inflation to ensure that their standards of living do not decline as they get older. Cuts in indexing would also be out of line with the promise of full indexing made in the 1996 federal budget speech concerning the proposed new Seniors Benefit.

- Trimming the Year's Basic Exemption. This would be grossly unfair to all workers at the lower end of the earnings scale because the impact on low-wage workers would be disproportionately high. Eliminating the exemption altogether would add to the administrative burden on business, particularly small business. One of the purposes of the exemption is to exclude people with no real attachment to the paid labour force from contributing to the Canada Pension Plan or claiming benefits.

THE THIRD LEVEL: OCCUPATIONAL PENSION PLANS

The first two levels of the retirement income system provide enough money to keep pensioners out of abject poverty, but not much more. Most pensioners need other sources of income to avoid a sharp drop in their standard of living after leaving the paid labour force.

The occupational pension plans and registered retirement savings plans that make up the third level of the system were intended to provide pensioners with up to 70 percent of their pre-retirement earnings. Unfortunately, relatively few people have been able to take full advantage of these two possibilities.

This chapter looks at occupational pension plans sponsored by employers, labour unions and professional organizations - plans that are sometimes called private pension plans, company pension plans, registered pension plans or employer-sponsored pension plans. The following chapter looks at RRSPs.

Occupational pension plans are essentially a way of deferring some of today's wages to provide tomorrow's retirement income. In that rough sense, they operate in much the same way as the Canada Pension Plan and Quebec Pension Plan. However, there are two important differences.

The Canada and Quebec Pension Plans cover virtually all members of the employed paid labour force. Occupational plans covered only 44.6 percent of paid workers at the time of the last Statistics Canada survey for 1993. Coverage was 85 percent among government employees, teachers, nurses and other workers in the public sector, but only 31 percent in the private sector.[18]

The other major difference is that CPP and QPP retirement benefits are fully indexed to the Consumer Price Index, while less than half of all occupational plan members had any automatic protection against inflation. Indexing was reasonably common in plans for workers in the public sector, but it was rare in plans in the private sector.

The spotty coverage and lack of inflation protection in occupational plans in the private sector are major flaws - some would say fatal flaws - in the third level of the retirement income system.

More than two million Canadians received $21.9 billion in income from occupational pension plans and related sources in 1993, according to the latest available taxation statistics from Revenue Canada. Of those people, 1.4 million were 65 years old or older, and they received nearly $13.7 billion from their plans.[19]

Among people still working, there were 5.2 million members of occupational pension plans or 44.6 percent of paid workers at last count. Coverage by sex was 46.8 percent for men and 41.9 percent for women.

There are two basic types of funding arrangements for pension plans - non-contributory and contributory. Non-contributory means the entire cost of the plan is borne by employers. Contributory means workers have to pay a share as well.[20]

Employee contributions usually range from five to ten percent of earnings and are collected by payroll deduction. Contributions by employees and employers alike are tax-deductible. Workers with the largest contributions get the largest tax breaks, and workers in higher tax brackets get proportionately larger tax savings than those in the lowest tax bracket.

In 1993, nearly 73 percent of all plan members belonged to contributory pension plans and the rest to non-contributory plans. Total contributions by plan members were $7.3 billion. Contributions by employers to both contributory and non-contributory plans were $12.9 billion.

There are two main ways pension benefits are delivered under occupational pension plans. Ninety percent of plan members in 1993 belonged to "defined benefit" plans, and most of the others belonged to "money-purchase" plans.

Money-purchase plans provide monthly incomes that are virtually impossible to estimate prior to retirement. Members build up money in their pension accounts over the years from contributions and earnings on investments. Upon retirement, the money is withdrawn and used to buy an annuity that pays a fixed amount of money every month.

Income from annuities depends in large part on the prevailing interest rates at the time of retirement. If rates are high, the money in the pension account could buy an annuity that delivers relatively large monthly payments. If rates are low, the monthly payments would be relatively low.

Defined-benefit plans avoid this type of uncertainty because they guarantee members a fixed percentage of pre-retirement earnings for every year of employment. The most common practice is to take average earnings for the five best years of a person's career and pay two percent of that figure for every year of service. In other words, a person with 35 years of service winds up with a pension that replaces 70 percent of his or her best pre-retirement earnings.

The maximum pension the federal government allows from a defined benefit plan is two percent of best earnings for each year of employment or $1,722.22 for each year of employment, whichever is less. A person who worked 35 years for the same employer and qualified for the maximum benefit each year would get a pension of $60,278 a year on retirement. To qualify for a pension of $60,278, however, a person would need best earnings of $86,111 a year or more during his or her time in the work force.[21]

Contrary to popular belief, and contrary to the way the Canada and Quebec Pension Plans operate, employers who sponsor defined-benefit plans do <u>not</u> match worker contributions dollar for dollar. What they do is contribute enough money to keep their pension funds actuarially sound - that is, large enough to cover all present pension payments for retired employees and all future pension payments for current employees. Employers contribute as much money, or as little, as needed to keep the plans on a sound financial footing.

Most occupational pension plans are regulated by the federal or provincial governments and have to meet certain minimum standards. The two levels of government agreed in 1986 to improve these standards and to make them more or less uniform in all parts of the country.

The federal government revised its Pension Benefits Standards Act, which covers workers in federally-regulated industries such as banking and telecommunications, and brought the changes into force on January 1, 1987. Small improvements in the pension plans for federal public servants, members of the Canadian Forces and Royal Canadian Mounted Police and

others under the federal jurisdiction were finally approved by Parliament in 1989. However, most of the improvements dealt only with benefits for surviving spouses and dependent children of deceased plan members.

Most provinces have updated the legislation covering occupational pension plans under their jurisdiction in recent years. Prince Edward Island passed new pension legislation in 1990, but the legislation was still not in force as of May 1996.

Plan Membership. In the past, many part-time workers were specifically excluded from the occupational pension plans run by their employers. Under the revised federal Pension Benefits Standard Act, full-time employees must be allowed to join existing plans after two years on the job, and part-time workers are eligible to join if they earn at least 35 percent of the Year's Maximum Pensionable Earnings under the Canada Pension Plan or Quebec Pension Plan for two consecutive years. Individual plans can either give eligible workers the option of joining or require that all eligible workers join. Similar membership requirements apply in most other jurisdictions.[22]

Vesting and Locking-In. The original intention of the federal and provincial governments was to have pension contributions vested and locked-in as soon as a worker is a plan member for two years. Most, but not all jurisdictions, now have legislation along these lines. Vesting means workers have a right to benefits from contributions made by themselves and also by their employers. Locking-in means the benefits are not actually paid until sometime in the future, usually not before age 55.

One practice that was fairly common until recently was to vest and lock-in pension contributions only when employees had ten years of service with the same employer. When workers changed jobs before ten years of service, they got back their own contributions with interest, but nothing in contributions made by their employers.

Early vesting and locking-in mean most pension contributions will actually go to pay pension benefits to workers after they retire. Refunds of contributions - which people might be tempted to spend immediately rather than putting into a retirement account - should become increasingly rare.

Portability. Most workers who change jobs now are able to transfer vested pension benefits to the pension plans of their new employers, to an individual RRSP where benefits are locked-in until retirement, or to an annuity that starts paying benefits upon retirement.

These options should work to the advantage of workers, provided they choose wisely. Transferring pension benefits to a new employer's pension plan makes sense if the plan is a good one. If not, workers might do better opting for a locked-in RRSP or deferred annuity.

Survivor Benefits. Ottawa and the provinces agreed that all plans should provide an option of survivor benefits equal to at least 60 percent of the pension of a plan member who dies after retirement. They further agreed that benefits should continue if the surviving spouse remarries.

However, providing an option is different from actually providing survivor pensions to all eligible plan members. The federal Pension Benefits Standard Act, for example, says survivor pensions can be waived with the written consent of both spouses.

With respect to plan members who die before they retire, there was no precise federal-provincial consensus. Most jurisdictions now provide that all or part of the vested pension benefits that had been built up at the time of death should go to the surviving spouse. Depending on the jurisdiction, the survivor benefits could be in the form of a lump-sum cash payment or a transfer to an RRSP or annuity.

As of 1993, half of all plan members were in plans that provided for lump-sum payments to surviving spouses based on the commuted value of the pension at the time of the plan member's death. Another 28 percent were in plans that provided survivor pensions of one kind or another - most often based on 50 or 60 percent of the plan member's pension entitlement. Roughly nine percent were in plans that provided only for a refund of contributions to the surviving spouse if the plan member died prior to retirement.[23]

Credit-Splitting on Marriage Breakdown. Neither the federal government nor most provincial governments make specific provision for the sharing of future pension benefits between spouses if their marriages break down.

Manitoba requires a 50-50 split and says credit-splitting cannot be overridden by a separation agreement or court order. Some other jurisdictions allow pension credits to be part of the package of assets divided on marriage breakdown. What could happen in these cases is that a wife could waive half her husband's occupational pension plan benefits in exchange for a larger share of the equity in the family home. That may serve the wife well in the short run, but leave her without adequate pension income in her old age.

Poor Coverage in the Private Sector

The most obvious weakness of occupational pension plans is their poor coverage of workers in the private sector. As we mentioned earlier, coverage in the public sector is reasonably complete, but only 31 percent of paid workers in the private sector belong to an occupational pension plan.

The contrast between coverage in the public and private sectors goes back many years.[24] There is simply no way that most private employers are voluntarily going to set up pension plans for their workers, and there has been little support over the years for governments to pass legislation to force the business community to provide occupational pension plans for their employees.

Within the private sector, coverage is heavily weighted in favour of employees of large businesses and industries and in favour of men rather than women.

About 65 percent of all occupational plan members in the private sector work for firms with 1,000 or more employees. Many of these firms are heavy industries where workers are represented by strong labour unions. On the other hand, occupational plan coverage is rare in firms with fewer than 100 employees and extremely rare in firms with fewer than ten employees.

Men far outnumber women in terms of membership in private-sector occupational plans, partly because men are more likely than women to be employed by large companies. There were just over 1.8 million men in the private sector who belonged to pension plans in 1993 and about 894,000 women.

The relative lack of coverage in the private sector as a whole is reflected in the overall statistics on occupational plans. As Table 8 shows, coverage overall in 1993 was down slightly to 44.6 percent. Among men, coverage dipped to 46.8 percent, while coverage among women rose slightly to 41.9 percent.[25]

TABLE 8

OCCUPATIONAL PENSION PLAN MEMBERSHIP

	Men	% of Paid Workers	Women	% of Paid Workers	Both Sexes	% of Paid Workers
1983	3,039,449	52.4%	1,525,174	35.9%	4,564,623	45.4%
1985	3,047,160	50.1%	1,621,221	35.6%	4,668,381	43.9%
1987	3,082,391	48.4%	1,762,716	35.8%	4,845,107	42.9%
1989	3,128,255	47.0%	1,981,138	37.4%	5,109,363	42.7%
1991	3,129,263	49.2%	2,188,827	40.8%	5,318,090	45.4%
1993	2,966,086	46.8%	2,248,561	41.9%	5,214,647	44.6%

It seems unlikely that occupational pension plans will ever be an important source of retirement income to people in low-wage jobs. Coverage by contributory pension plans increases sharply as incomes rise. Coverage by non-contributory plans is probably similar, but neither Statistics Canada nor Revenue Canada has income data on members of non-contributory plans. As Table 9 on the next page shows, only a small percentage of the poorest wage-earners belonged to contributory plans in 1993, and the average contribution by plan members with incomes under $10,000 was a mere $234. At the other end of the income scale, among workers with incomes over $50,000, coverage was much more complete and the average contribution by plan members was $3,211.[26]

TABLE 9

MEMBERSHIP IN CONTRIBUTORY OCCUPATIONAL PLANS BY INCOME, 1993

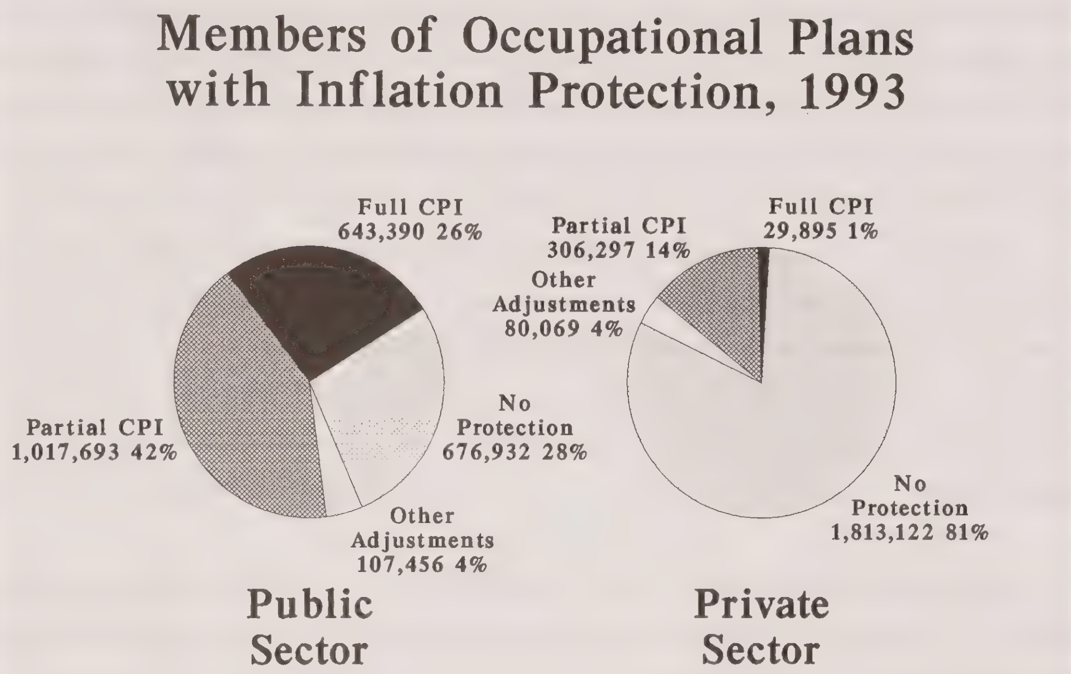
Income Range	Number of Contributors	Persons with Employment Income	Contributors as % of Persons with Employment Income	Average Contribution to Pension Plan
Under $10,000	20,780	622,000	3.3%	$234
$10,000-20,000	268,190	2,444,210	10.9%	$481
$20,000-30,000	749,220	2,484,500	30.1%	$955
$30,000-40,000	912,860	1,972,300	46.3%	$1,533
$40,000-50,000	694,900	1,295,730	53.6%	$2,120
Over $50,000	977,040	1,852,170	53.0%	$3,211
Total	3,622,980	10,670,940	34.0%	$1,893

Spotty Inflation Protection

Another major flaw in occupational pension plans is the lack of inflation protection, especially in the private sector. Plans are free to provide cost-of-living protection for pensioners, but they are not required to do so by governments.

Indexation is a vital part of any good pension plan because many pensioners live well beyond the age of retirement. Even a small amount of inflation can cut into the purchasing power of a pension cheque in short order. At inflation of four percent a year, for example, pensioners lose about 30 percent of their purchasing power in ten years without indexation. A monthly cheque of $600 becomes a cheque worth only $416.

Less than half of the members of defined-benefit pension plans have any protection at all against inflation. Those who are protected are heavily concentrated in the public sector, as shown in Graph E.[27]



Graph E

In the public sector, 26 percent of plan members had the ideal form of inflation protection - increases in pension benefits that matched increases in the Consumer Price Index. Another 42 percent had plans that provided for increases to cover some, but not all of the increases in the CPI. Relatively few workers had no protection at all.

In the private sector, only one percent of all plan members had full CPI inflation protection, and only 14 percent had partial CPI protection. Most of the rest - 81 percent in all - had no protection at all.

The lack of inflation protection appears in another way in those pension plans which are based on lifetime or career earnings. In 1993, 482,507 people or nine percent of plan members belonged to career earnings plans, most of them in the private sector.

Career earnings plans normally consider a person's earnings from year to year with no adjustments for inflation. For example, a person who started work in 1953 at an annual salary of $2,000 a year, got regular increases from year to year, and finished working in 1993 at an annual salary of $40,000 a year would probably wind up with average career earnings in the order of $20,000 a year. The person would then retire with a pension based on $20,000 a year rather than on his or her most recent pre-retirement earnings of $40,000 a year.[28]

Fortunately, most occupational plans treat members much better by basing their pensions on the best years of earnings or the last years of earnings. That means that a person can at least start out with a pension that is in line with the cost of living.

A Limited Role

Occupational pension plans play a limited role in providing retirement income for Canadians. Coverage continues to be concentrated in the public sector and in large industries in the private sector.

Changes in the laws in recent years affecting vesting, locking-in and portability should make it possible for more plan members to collect regular pension cheques when they eventually retire. Other changes, especially those regarding survivor benefits, are welcome and long overdue. However, unless workers are lucky enough to belong to public sector pension plans or the few private sector plans that provide for full or nearly full indexation, whatever benefits they do receive are bound to be eroded by inflation.

THE THIRD LEVEL (CONTINUED): REGISTERED RETIREMENT SAVINGS PLANS

The other main component of the third level of the retirement income system is registered retirement savings plans or RRSPs. Like occupational pension plans, RRSPs are intended to help people build up retirement income to replace a portion of their pre-retirement earnings. And like occupational pension plans, they have turned out to be most helpful to middle-income and upper-income Canadians.

Registered retirement savings plans encourage regular saving for retirement through tax breaks. Taxfilers deduct the amount of their RRSP contributions from their taxable incomes each year and thereby pay lower federal and provincial income taxes.

People can cash in their RRSPs when they retire and use the proceeds to buy annuities that pay them fixed amounts of money every month. The income from annuities is taxable, but since most taxpayers are in lower tax brackets after they retire, they pay less in taxes than they would have paid during their working lives.

Money accumulated in an RRSP can also be rolled over into a registered retirement income fund or RRIF. Registered retirement income funds have the effect of indexing retirement income to age 90 because they provide for an increase in payouts from year to year. Taxes are paid only on the money received each year.[29]

The latest available taxation statistics show that more than 5.1 million Canadians made contributions to RRSPs for the 1993 tax year - or 26 percent of all the people who filed tax returns. The total amount contributed was $17.5 billion, and the average contribution was $3,410. There were 2.9 million men with an average contribution of $3,897 and nearly 2.2 million women with an average contribution of $2,756.[30]

The federal government puts limits on the amount of money people in different circumstances can contribute to RRSPs. The 1996 federal budget proposed to freeze the overall limit on contributions to 18 percent of earned income or a maximum contribution of $13,500 a year through the year 2003.

People who do not belong to occupational pension plans can contribute up to $13,500 a year to RRSPs. Members of occupational pension plans have the annual limit reduced by a "pension adjustment" calculated by Revenue Canada. Roughly speaking, the pension adjustment measures the value of pension entitlements earned by a member of an occupational pension plan during any given year.

Under changes in federal legislation that went into effect in 1991, RRSP contribution room that is not used in a given tax year can be carried forward and used in later tax years. The 1996 budget proposed to allow this unused contribution room to be carried forward indefinitely. The existing carry-forward is limited to seven years.

The carry-forward allows people whose financial circumstances vary from year to year a better opportunity to maximize their RRSP contributions. They can take a break from RRSP contributions in years when money is tight and make up the difference in better times.

More For The Rich

There is no doubt that the tax savings linked to RRSPs make them a very attractive option for the well-to-do. The big problem, of course, is that many Canadians do not have lots of extra money to put aside on a regular basis.

Table 10 shows the income ranges of people ages 25 through 64 who contributed to RRSPs for 1993. Sixty-nine percent of the taxfilers with taxable returns and incomes of $50,000 or more took advantage of RRSPs and made an average contribution of $5,155. Only 23 percent of the taxfilers with incomes under $10,000 put money into RRSPs, and their average contribution was only $1,115.[31]

TABLE 10

CONTRIBUTORS TO RRSPs, AGES 25-64, BY INCOME CLASS, 1993

Income Class	Number of Contributors Ages 25-64	Persons with Taxable Returns Ages 25-64	Contributors as Percentage of Persons with Taxable Returns	Average Contribution to RRSP
Under $10,000	132,063	579,540	23%	$1,115
$10,000-20,000	531,582	2,342,590	23%	$1,661
$20,000-30,000	885,262	2,538,320	35%	$2,058
$30,000-40,000	973,751	2,020,930	48%	$2,621
$40,000-50,000	759,907	1,337,860	57%	$3,208
Over $50,000	1,358,792	1,958,270	69%	$5,155
Total	4,641,357	10,741,030	43%	$3,203

What is even more inequitable is that the current system of tax deductions for RRSP contributions provides the largest tax savings to the well-to-do. An RRSP tax deduction of $1,000 is worth roughly $473 in federal and provincial tax savings to a taxpayer in the highest income bracket. The same deduction of $1,000 is worth only about $269 to a taxpayer in the lowest bracket.

The federal government decided in 1988 to convert personal exemptions and most deductions to tax credits. Even the tax deductions for contributions to the Canada and Quebec Pension Plans were converted to credits. However, Ottawa refused to do the same for contributions to occupational pension plans and RRSPs, which continue to be tax-deductible.

Tax credits are fairer than deductions because they provide the same savings regardless of which tax bracket a person is in. For example, the value of the tax credit for maximum CPP contributions in 1996 is about $240. A taxpayer in the top tax bracket gets a tax saving of $240, and a taxpayer in the lowest tax bracket gets the same tax saving of $240.

The National Council of Welfare estimates that the federal government gave up roughly $4.4 billion in tax revenues in 1993 because it allowed tax deductions for contributions to RRSPs. If Ottawa had given tax credits instead of tax deductions, the losses would have been limited to about $3 billion.[32] In other words, the Finance Department's own refusal to switch to tax credits for RRSP contributions added an unnecessary $1.4 billion to the federal deficit that year.

All in all, RRSPs do encourage saving for retirement, but primarily by those who have large amounts of discretionary income from year to year. They reward the rich the most, they offer modest encouragement to people with average incomes and they provide very little help to the poor. Given the financial realities facing people in different income groups, there is unlikely to be any change in this pattern in years to come.

CONCLUSION

Although a number of improvements were made in all three levels of Canada's retirement income system in recent years, the system still has profound limitations that have not been adequately addressed by governments.

At the first level, combined federal and provincial benefits are not high enough to keep all seniors out of poverty. Although poverty among the elderly is much less widespread than it was a generation ago, 17.2 percent of Canadians 65 and older were living in poverty in 1994. The new Seniors Benefit proposed by the federal government would give the poorest seniors an additional $120 a household per year - not enough to make any noticeable difference in the degree of poverty experienced by seniors.

At the second level, the one shortcoming of the Canada Pension Plan and Quebec Pension Plan that overshadows all others is the low limit on retirement benefits. The plans were designed to replace a maximum of 25 percent of earnings up to the average industrial wage. Even with a full CPP or QPP pension and the Old Age Security pension, a retired person gets a sizable Guaranteed Income Supplement and still winds up below the poverty line for a large city. Sadly, the federal and provincial governments appear to be much more interested in trimming CPP benefits than enhancing them.

At the third level, the improvements made in occupational pension plans are welcome and long overdue and seem certain to provide tangible benefits to workers lucky enough to be members. However, occupational plans in the private sector still have major flaws - poor coverage and abysmally poor inflation protection.

Well-off employees rather than those with below-average incomes are the main beneficiaries of occupational pension plans. The same holds true for registered retirement savings plans. RRSPs have long been a choice tax break for wealthy Canadians, and a major drain on the federal treasury at a time when the government is supposedly working hard to reduce the deficit.

APPENDIX A

THE RETIREMENT INCOME SYSTEM

LEVEL ONE	Beneficiaries	Eligibility
• Old Age Security	3.5 million 65+	Full Benefits to $53,215 in Net Income
• Guaranteed Income Supplement	1.4 million 65+	Low-Income People
• Spouse's Allowance	106,000 Ages 60-64	Low-Income People
• Provincial/Territorial Supplements	250,000 Mostly 65+	Low-Income People

LEVEL TWO	Contributors	Pensioners
• Canada Pension Plan	9.7 million	2.3 million
• Quebec Pension Plan	3.2 million	0.8 million
Total	12.9 million	3.1 million

LEVEL THREE	Plan Members or Contributors	Retired Beneficiaries
• Occupational Pension Plans	5.2 million	2.0 million
• Registered Retirement Savings Plans	5.1 million	500,000?[33]

APPENDIX B

TAX BREAKS FOR SENIORS

In addition to the tax deductions and tax credits for pension and RRSP contributions that were described in the body of this report, older Canadians are able to take advantage of two other tax breaks designed specifically with them in mind: the age credit and the credit for the first $1,000 in pension income from an occupational pension plan. As part of the package of proposals in the 1996 budget, the age and pension income tax credits would be eliminated when the new Seniors Benefits is introduced in the year 2001.

Current tax law allows most seniors 65 and older to claim a tax credit by virtue of their age. The amount that appeared on the income tax form in 1995 was $3,482, but the actual federal tax break was 17 percent of $3,482 or $592. Adding in savings on the federal surtax and provincial income tax savings at a rate of 55 percent of basic federal tax, the overall tax savings from the age credit amounted to $935 in 1995.

However, the maximum age credit goes only to seniors with net incomes below $25,921. Seniors with higher incomes have the gross amount of the credit reduced by 15 cents for every dollar over $25,921. Seniors with net incomes of $35,921 or $10,000 higher than the threshold, for example, lose $1,500 of the basic amount on the tax form. The entire credit disappears once net income reaches $49,134.

A second credit aimed primarily, but not exclusively, at seniors that is scheduled to disappear in 2001 is the pension income amount to eliminate taxes on the first $1,000 of income from an occupational pension plan or personal retirement income plan. Occupational pension plan means a private or company pension plan, not Old Age Security, the Canada Pension Plan, the Quebec Pension Plan or the Saskatchewan Pension Plan.

For people 65 and older, the credit can be used to eliminate taxes on the first $1,000 in pension payments from an occupational pension plan, annuity payments from a registered retirement savings plan or payments from a registered retirement income fund. It cannot apply to lump-sum withdrawals from a pension plan or RRSP. For people under 65, the pension

income credit is available in the case of life annuity payments from an occupational pension plan.

The maximum federal tax break is 17 percent of $1,000 or $170. With savings on the federal surtax and provincial taxes added in, the total tax break is $269.

Under the current tax system, Revenue Canada allows married seniors with little or no taxable income to transfer any unused age or pension income credits to their spouses. That has the effect of doubling the maximum tax break for some couples. For example, a one-income senior couple with pension income of $2,000 could claim a pension income amount of $1,000 for each spouse, even if only one of the spouses actually received pension income and only one was subject to income tax.

The current cost of the age credit to the federal government in the neighbourhood of $1.5 billion a year, and cost of the pension income credit is about $340 million a year. Provincial governments aside from Quebec and territorial governments also lose revenue from these tax breaks because their tax systems are linked to the federal system. Quebec has its own provincial tax system.

FOOTNOTES

1. The statistical information in this chapter was provided by Human Resources Development Canada. Among the most useful sources of information is the Department's monthly Statistical Bulletin on Old Age Security and the Canada Pension Plan.

2. As of January 1996, there were agreements in force between Canada and the following countries: Antigua and Barbuda, Australia, Austria, Barbados, Belgium, Cyprus, Denmark, Dominica, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Jamaica, Jersey and Guernsey, Luxembourg, Malta, The Netherlands, Norway, Portugal, Saint Lucia, Saint Kitts-Nevis, Spain, Sweden and the United States.

3. Income that is not taxable under the Income Tax Act is not considered in calculating entitlements for the Guaranteed Income Supplement. As well, the Old Age Security Act specifically exempts the following sources of income for GIS purposes: Old Age Security pensions, death benefits under the Canada Pension Plan and Quebec Pension Plan, provincial and territorial income supplements, provincial and territorial welfare payments, and home insulation grants.

   Both the Guaranteed Income Supplement and the Spouse's Allowance are based on income rather than need in the strict sense of the word. People qualify for benefits on the basis of a simple, straight-forward income test. Personal assets such as a home or car are not considered at all. Income-producing assets such as bonds and rental property are considered only to the extent that they actually provide income in any given year.

4. For details of how poverty among the elderly has changed in recent years, see the National Council of Welfare's Poverty Profile 1994. The poverty rate for couples 65 and older fell from 22.2 percent in 1980 to 6.8 percent in 1994, the latest year for which statistics are available. The poverty rate for unattached women 65 and over fell from 68.7 percent in 1980 to 44.1 percent in 1994, while the rate for elderly unattached men dropped from 57.8 percent to 25.2 percent.

5. The poverty lines are described in detail in Poverty Profile 1994. They are calculated by Statistics Canada for individuals and families of different sizes living in areas ranging from rural areas to large metropolitan centres. The larger the family or community, the higher the poverty line. Statistics Canada calls them "low-income cut-offs," while the National Council of Welfare calls them "poverty lines." Regardless of the term, they represent levels of gross income where families or individuals have to spend inordinate proportions of their income on food, shelter and clothing.

6. Prior to 1985, the Spouse's Allowance program covered only those widows and widowers who first qualified for the allowance when their spouses were alive. Among

those excluded from the program were widows whose husbands died before age 65 and widows who were under 60 when their pensioner husbands died.

7. Nova Scotia has a program called Special Social Assistance for low-income seniors, but it is more of a welfare program than an income supplement.

8. Provincial and territorial estimates, unpublished data from Statistics Canada's Survey of Consumer Finances.

9. Poverty Profile 1994.

10. The amount of the Alberta supplement varies with the type of housing. The rates shown in the table are for renters. The maximum rates for homeowners were $1,800 a year for a single person and $2,950 for a two-pensioner couple. One of the reasons the supplements are large compared to other jurisdictions is that the new supplement is designed to cover some housing and health care costs previously covered by other provincial programs.

11. Many provincial and territorial programs for seniors are described in the Inventory of Income Security Programs in Canada compiled by Human Resources Development Canada.

12. Most of the statistical information in this chapter was provided by Human Resources Development Canada.

13. Poverty Profile 1994, p. 70.

14. Human Resources Development Canada, Statistical Bulletin, January 1996.

15. Ontario has a veto over changes in the Canada Pension Plan because it alone has more than one-third of the population of Canada. Changes in the plan require the approval of the federal government and two-thirds of the provinces with two-thirds of the population.

16. To the extent that the earnings of wives are less than the earnings of their husbands, credit-splitting benefits wives. In cases where wives earn more than their husbands, it benefits husbands.

17. Copies of the paper are available from the Finance Department's distribution centre in Ottawa or on the Internet at http://www.fin.gc.ca.

18. Statistics Canada, Canada's Retirement Income Programs: A Statistical Overview, Catalogue No. 74-507-XPB, Chapter Two. Much of the statistical information for this chapter comes from this source or from Statistics Canada, Pension Plans in Canada, Catalogue No. 74-401SE.

19. Revenue Canada, Tax Statistics on Individuals (1993 Tax Year), Tables 2 and 4.

20. Some analysts argue that there is no real difference between contributory and non-contributory plans. Employers have limits on the amounts they are prepared to spend on salaries and benefits. If the arrangement is to have a non-contributory plan, presumably workers would get lower wages or less generous fringe benefits than their counterparts at a conmpany that had a contributory pension plan.

21. The federal government originally intended to index the limit of $1,722.22 to increases in the average wage. However, the 1996 budget speech said the limit would be frozen through the year 2004.

22. For more details about the requirements in each province, see Appendix I of Pension Plans in Canada.

23. Unpublished data from Statistics Canada.

24. Unpublished data from Statistics Canada. The federal agency recently adopted new definitions for public sector and private sector pension plans, so the data in this report is not directly comparable with previously published data. However, the previous data also showed that occupational pension plan coverage was commonplace in the public sector and very spotty in the private sector. Using the old definitions, private sector coverage barely changed at all between 1970 and 1986.

25. Canada's Retirement Income Programs: A Statistical Overview, p. 47.

26. Tax Statistics on Individuals, Table 2A. The category "persons with employment income" was used as a proxy for the total number of people in each income class who would be eligible to join an occupational pension plan if one were available. We used the table for taxable returns to limit the ranges to people who actually earned enough income in 1993 to pay income taxes.

27. Unpublished data from Statistics Canada. Among members of the public sector plans in Graph E with only partial indexing, about 55 percent had annual indexing arrangements of CPI minus three or four percentage points. In other words, pensions would increase only to cover inflation in excess of three or four percent a year. Most of other partial indexing arrangements had limits on CPI indexing that allowed annual increases of up to ten percent a year.

    Among members of private sector plans with partial indexing, caps on the amount of annual CPI indexing were the most common arrangement. About 39 percent of plan members with partial indexing were limited to increases of four percent a year or less.

28. The Canada and Quebec Pension Plans also use career earnings, but each year's earnings are adjusted for the growth in average earnings up to the year of retirement.

29. The basic idea behind registered retirement incomes funds is simple, but some of the options are anything but. For more information, consult one of the annual consumer guides on retirement income plans.

30. Tax Statistics on Individuals, Table 4.

31. Statistics Canada, Retirement Savings Through RPPs and RRSPs, 1991 to 1993, Catalogue No. 74F0002XPE, Table 6B, and Tax Statistics on Individuals, Table 6. The age group 25-64 was chosen by Statistics Canada for special analysis, presumably because that would be the most likely time of life for people to make contributions to RRSPs.

32. The calculations assumed that taxpayers with incomes of $50,000 or more saved 29 percent of basic federal tax because of their RRSP deductions, and taxpayers with incomes of less than $50,000 saved 22 percent of basic federal tax on average. Under a system of tax credits, we assumed federal tax savings of 17 percent on all contributions to RRSPs.

    Provincial and territorial governments also lose revenue because of tax deductions for RRSPs, and their losses would be more modest with tax credits instead of tax deductions.

33. The figure of 500,000 is the number of people who reported income from all kinds of annuities in 1993, including annuities purchased with the proceeds of RRSPs. The figure does not include beneficiaries of registered retirement income funds, which are grouped together in Revenue Canada taxation statistics with beneficiaries of occupational pension plans.

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